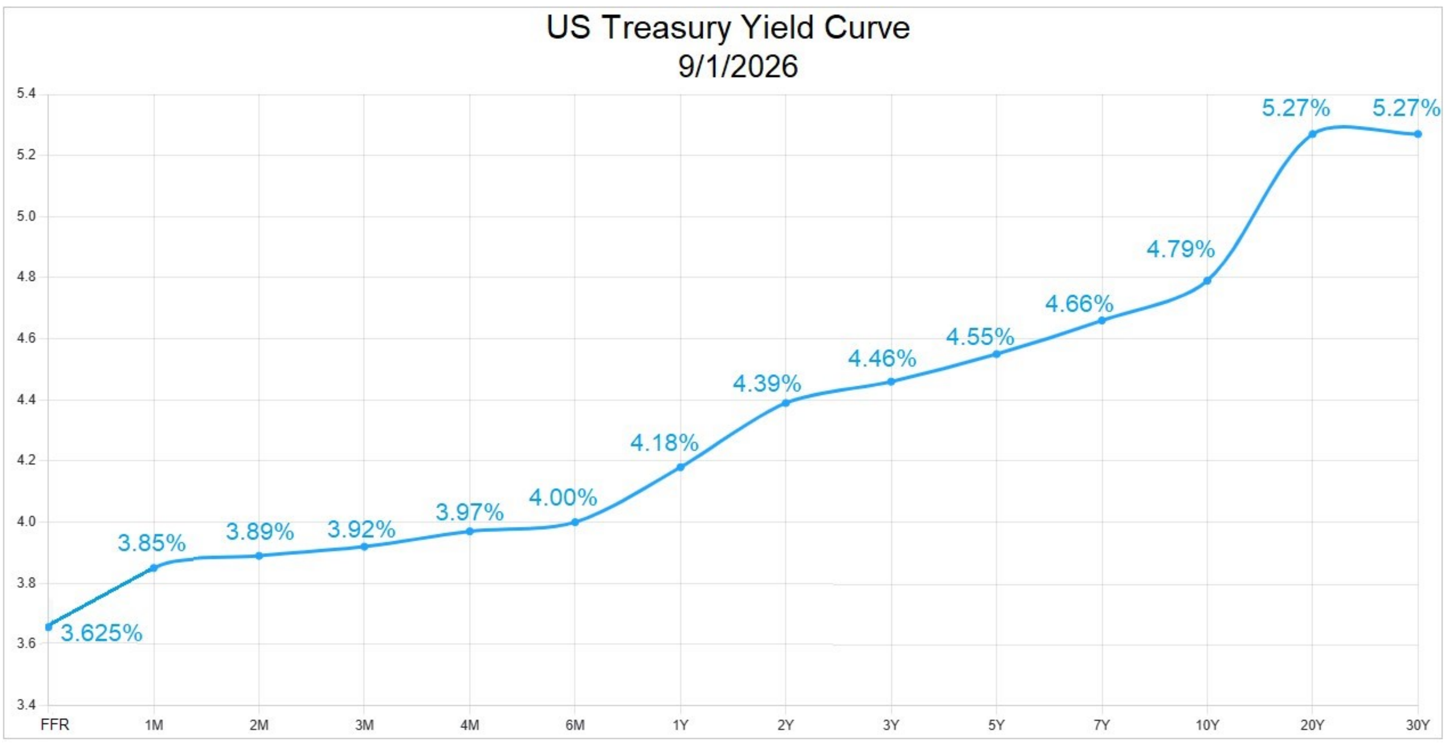
Chart of the Month

September 2026



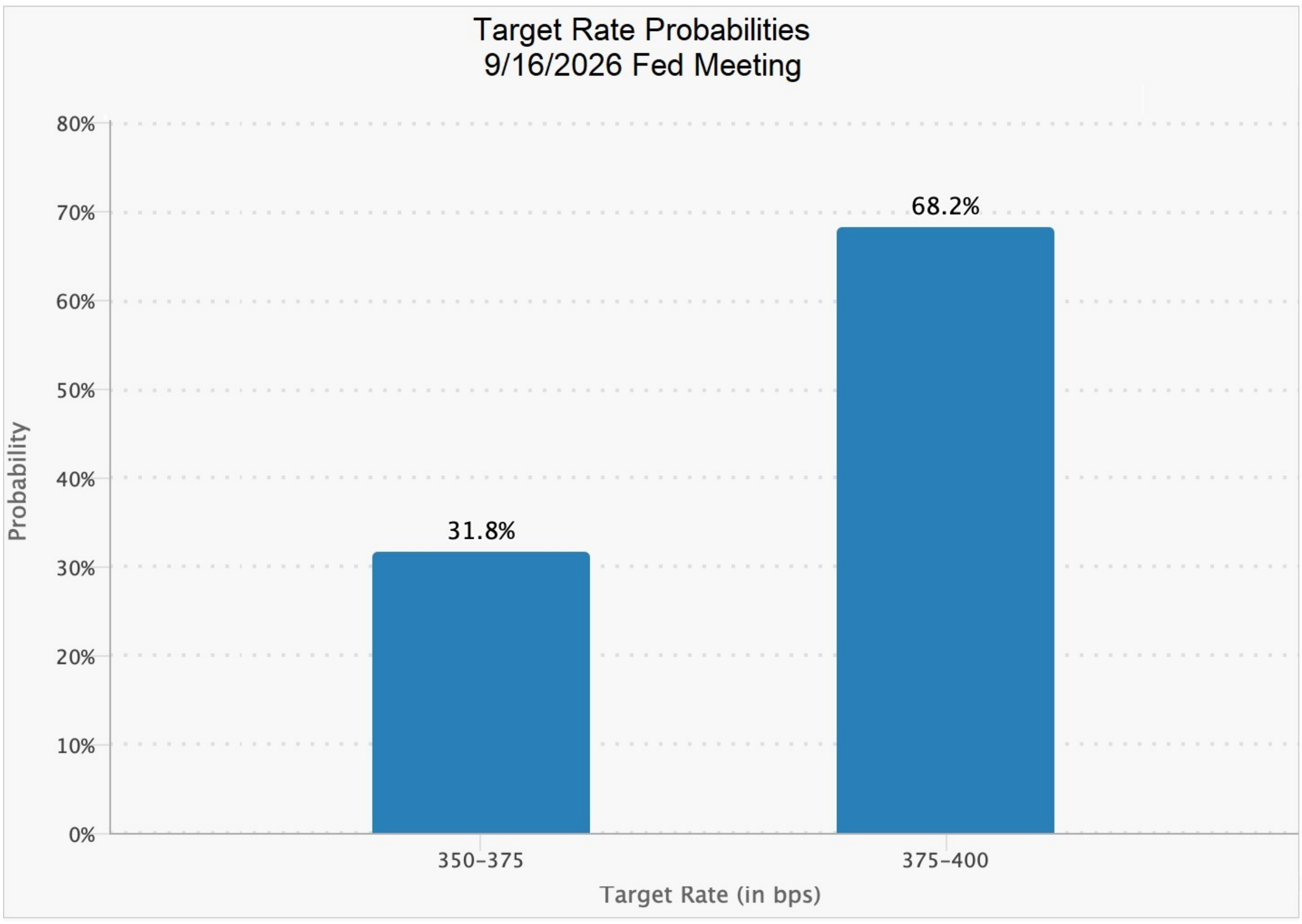
The Federal Open Market Committee (FOMC) is scheduled to meet on September 16 to review the federal funds rate as it does every six weeks. We discussed the last meeting in our Chart of the Month in late July. At that time, the yield on the two-year Treasury was 4.23%. Since then, it has increased to 4.39% (as shown above), putting more pressure on Chair Kevin Warsh and the 11 other voting members of the FOMC to raise the range on the fed funds rate (FFR) from 3.50%-3.75% to 3.75%-4.00%.

The spread between the two-year Treasury and the midpoint on the FFR is now 77 basis points (0.77%), a premium not seen since the Federal Reserve was aggressively hiking rates in 2022 in an attempt to dampen the inflationary spiral resulting from extraordinarily loose fiscal and monetary policies in the aftermath of the pandemic and government shutdown.

As displayed below, the Fed Funds Futures market is now assigning a 68% probability that the Fed will raise the FFR to 3.75%-4.00%. If the odds remain at or near 68%, we believe the Fed will have no choice other than to bump up the FFR in two weeks. Otherwise, Warsh, who reiterated the goal of lowering the inflation rate from 3.0%+ to the Fed's target of 2.0% in a speech at Jackson Hole last week, will run the risk of losing credibility, damaging his reputation as well as the confidence of bond market participants. A lack of action could cause the yield on the 10-year Treasury to jump to 5.0% or higher based on the belief that the Fed is "talking the talk and not walking the walk."

Ironically, higher short-term rates should firm longer rates because it would send a message that the Fed is truly intent on reducing inflation toward its target. Of note, one hike usually leads to a second and there is clearly room for two 25 bp increases while still leaving an upward-sloping yield curve.

Meanwhile, the stock market would most likely prefer slightly higher rates at the short end than greater longer-term yields. The latter determines the discount rate that investors use to value equities. Higher yields generally mean lower price-earnings multiples (P/Es) whereas lower yields normally signify higher P/Es.



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